FINANCIAL STATEMENTS

Citizens Property Insurance Corporation
Years Ended December 31, 2004 and 2003

Citizens Property Insurance Corporation

Audited Financial Statements

Years Ended December 31, 2004 and 2003

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Citizens Property Insurance Corporation

Management's Discussion and Analysis

December 31, 2004 and 2003

This discussion provides an assessment by management of the current financial position and results of operations for Citizens Property Insurance Corporation (Citizens or the Company). Management encourages readers to consider the information presented here in conjunction with additional information included in the accompanying financial statements and footnotes.

Citizens was created to provide certain residential property and casualty insurance coverage to qualified risks in the State of Florida under circumstances specified by Section 627.351(6) of the Florida Statutes. The intent of the legislation is that property insurance be provided through Citizens to applicants who are in good faith entitled to procure insurance through the voluntary market but are unable to do so. Citizens is the successor entity resulting from a combination of the Florida Residential Property and Casualty Joint Underwriting Association (the FRPCJUA) and the Florida Windstorm Underwriting Association (the FWUA). The FRPCJUA was renamed Citizens and the FWUA rights, obligations, assets, liabilities and all insurance policies were transferred to Citizens.

All revenues, expenses, assets and liabilities are divided into three separate accounts: the Personal Lines Account (PLA), the Commercial Lines Account (CLA) and the High-Risk Account (HRA). See Footnote 1 for a brief history of each account.

Financial Highlights

- The liabilities of Citizens exceed its assets at the close of the most recent year by $251 million (*net deficit*).

- The Company's total net assets decreased by $1.9 billion. This decrease is attributable to a decrease in available funds generated from operations due to increased claim payments.

- Operating revenues increased 24% primarily due to an increase in new business, in addition to, an increase in premium rates.

- Operating expenses increased 673% primarily due to an increase in loss and loss adjustment expense incurred for the current accident year.

- Nonoperating expenses decreased 29% due to a decrease in both interest expense and line of credit fees.

Overview of Financial Statements

Prior to January 1, 2003, Citizens prepared its financial statements in accordance with the accounting standards issued by the Financial Accounting Standards Board (FASB). In June 1999, the Governmental Accounting Standards Board (GASB) issued Statement No. 34, “*Basic Financial Statements — and Management’s Discussion and Analysis — for State and Local Governments*.” This standard established financial reporting standards for state and local governments and certain funds of those governmental entities. The State of Florida elected to adopt the provisions of GASB Statement No. 34 for its fiscal year beginning July 1, 2001. To be consistent with State reporting practices, Citizens has elected to adopt the provisions of this standard effective January 1, 2003. Under the provisions of GASB Statement No. 34, Citizens is classified as an enterprise fund, which is a type of proprietary fund, and prepares its financial statements in accordance with the provisions of accounting standards issued by the GASB and only FASB pronouncements issued before December 1, 1989 that do not conflict with or contradict GASB pronouncements.

This discussion and analysis is intended to serve as an introduction to Citizens’ basic financial statements, which consist of the statement of net assets, statement of revenues, expenses and changes in net assets and the statement of cash flows. This report also contains other supplementary information in addition to the basic financial statements.

The *statement of net assets* presents information on all of the Company’s assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of Citizens is improving or deteriorating.

The *statement of revenues, expenses and changes in net assets* presents information showing how the Company’s net assets changed during the most recent year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows.

The *statement of cash flows* presents information about the cash receipts and cash payments during the year. The statement shows the cash effect of operations, investing and financing transactions during a given period.

Notes to the financial statements. The notes provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes to the financial statements can be found beginning on page 8 of this report.

Overview of Financial Statements (continued)

Other information. In addition to the basic financial statements and accompanying notes, this report also presents certain *required supplementary information* concerning the Company's revenues, expenses and claims development information for the last ten policy years.

Financial Analysis

A summary of Citizens' Statement of Net Assets is presented below:

	2004	**2003**	**% Change**
	(In thousands)		
Assets			
Cash and investments	**$ 4,186,489**	$ 4,170,381	0.4%
Receivable for securities	**–**	45,340	100%
Interest due and accrued	**23,848**	24,131	1%
Premium receivable, net	**6,027**	2,703	123%
Other assets	**144,963**	87,775	65%
Total assets	**$ 4,361,327**	$ 4,330,330	0.7%
Liabilities and net assets			
Loss and loss adjustments expense reserves	**$ 1,607,050**	$ 138,705	1,059%
Unearned premiums	**667,386**	571,000	17%
Borrowed money	**2,115,624**	1,652,163	28%
Payable for securities	**–**	116,840	100%
Federal income taxes payable	**54,899**	54,899	0%
Taxes, licenses and fees payable	**30,972**	22,774	36%
Other, liabilities	**136,429**	136,256	0.1%
Total liabilities	**4,612,360**	2,692,637	71%
Net assets (deficit)	**(251,033)**	1,637,693	85%
Total liabilities and net assets	**$ 4,361,327**	$ 4,330,330	0.7%

Assets

As shown above, total assets increased $31 million, or 0.7%, during 2004 primarily due to an increase in invested assets caused by cash flows provided by non-capital financing activities offset by cash used in operations to pay hurricane claims.

Financial Analysis (continued)

Long and short-term investments totaled $2.76 billion at December 31, 2004. Because the primary purpose of the investment portfolio is to fund future claim payments, the Company employs a conservative investment philosophy. The Company's portfolio consists of debt instruments such as: US Treasury and US government securities, corporate bonds, collateralized mortgage obligations and asset-backed securities. These securities grew $37 million, or 1%, in 2004 due largely to the net bond proceeds received in excess of debt service payments made during the year.

Cash and cash equivalents decreased $20.5 million, or 1%, during 2004. This decrease is due to cash used in operations, primarily to fund hurricane losses. Approximately $1.15 billion of the Company's operating funds are invested in a short-term portfolio managed by the Treasurer of the State of Florida and are invested, along with State funds, in securities which are rated in the highest category by a nationally recognized rating service.

Premium receivable increased $3 million, or 123%. This increase is attributed to an increase in written premiums and the timing of collections near year-end 2004 as compared to the prior year. Citizens does not anticipate any unusual collection problems with respect to the premium balances.

Other assets increased $57 million, or 65%. This increase is attributed primarily to prepaid reinsurance premiums. Prepaid reinsurance premiums increased due to an increase in assumption activity by takeout companies during 2004 as compared to the prior year.

During the year, Citizens had no significant capital assets activity.

Liabilities

Total liabilities increased $2 billion, or 71%, during 2004. The increase is due to increases in losses and LAE reserves, unearned premiums, notes payable, taxes licenses and fees payable, offset by a decrease in amounts payable for securities.

Loss and loss adjustment expense (LAE) reserves are stated at the Company's estimate of the ultimate loss (as determined by an outside actuary) of settling all incurred but unpaid claims. Loss and LAE reserves are not discounted for book purposes.

Financial Analysis (continued)

Activity with respect to unpaid losses and LAE for 2004 and 2003 is displayed below:

Loss and LAE Reserve Summary	**2004**	**2003**
	(In Thousands)	
Unpaid at beginning of year	**$ 138,705**	$ 83,144
Losses and LAE incurred in current year:		
Current year losses and LAE	**2,721,512**	243,767
Prior year losses and LAE	**(15,498)**	(19,439)
	2,706,014	224,328
Losses and LAE paid in current year:		
Current year losses and LAE	**1,145,602**	124,414
Prior year losses and LAE	**92,067**	44,353
	1,237,669	168,767
Unpaid losses and LAE at end of year	**$ 1,607,050**	$ 138,705

Loss and LAE reserves grew $1.5 billion or 1,059%, as of the year ended 2004 compared to the prior year ended 2003. Reserves related to hurricanes Charley, Frances, Ivan and Jeanne were $1.42 billion as of December 31, 2004 as determined by our independent actuary.

Unpaid losses and LAE reserves not related to hurricanes increased from $138 million as of December 31, 2003 to $187 million as of December 31, 2004. This increase is due largely to an increase in the Company's overall exposure in 2004 compared to 2003 caused by growth in new policies.

Unearned premiums increased due to an increase in written premiums. Unearned premiums increased $96 million, or 17%, which correlates to a 21% increase in direct written premiums caused by increases in both policy counts and premium rates.

Borrowed money increased $463 million, or 28%, during 2004 due mainly to the $750 million in Bonds issued, offset by $275 million in principal repayments made during the year.

Financial Analysis (continued)

Security transactions are recorded on the trade date rather than the settlement date. Occasionally, securities are purchased and recorded in the Company’s financial records, but the cash has not been disbursed as of the balance sheet date. At December 31, 2004 and 2003, the Company owed brokers $0 and $117 million, respectively. This decrease is due to the restrictions Citizens has placed on managers to avoid settlements over month end.

Federal income tax payable remains at $52.5 million, which reflects a federal income tax refund received in 2003 on behalf of the FWUA. During 2002, FWUA transferred its assets and liabilities to the Company in accordance with Florida Statute 627.351(6)(1)(2). Subsequently, the FWUA filed amended state and federal income tax returns claiming refunds in excess of $182 million related to this transfer. Management anticipates the refund will be contested by the Internal Revenue Service and has recorded the proceeds as a liability until uncertainties surrounding the matter are resolved.

Taxes, licenses and fees payable increased $8 million, or 36%, during 2004. This increase is mainly due to the increase in premium tax that that is directly related to the increase in direct written premium.

Financial Analysis (continued)

A summary of Citizens Statement of Revenues, Expenses and Changes in Net Assets and certain key financial ratios are presented below:

	2004	2003	% Change
	(In Thousands)		
Operating revenue:			
Net earned premiums	**$ 1,022,503**	$ 823,902	24%
Operating expenses:			
Losses and LAE incurred	**2,706,014**	224,328	1,106%
Other underwriting exp	**191,333**	150,578	27%
	2,897,347	374,906	673%
Operating (loss) income	**(1,874,844)**	448,996	518%
Non operating expenses	**(13,882)**	(19,490)	29%
Change in net assets	**$ (1,888,726)**	$ 429,506	540%
Policies in force	**873,996**	820,255	7%
Underwriting ratios			
Loss and LAE ratio (calendar year)	**265%**	27%	
Expense ratio	**19%**	18%	
Combined ratio	**283%**	45%	

Earned premiums increased $198 million, or 24%, during 2004 primarily due to premium rate increases and growth of new business. This increase is partially offset by an increase in premiums ceded to the Florida Hurricane Catastrophe Fund ("FHCF") and Takeout Companies.

Financial Analysis (continued)

Policies in force before Takeouts increased 155,799, or 18%, during 2004 compared to 2003. The increase in policies is due to the following factors;

- Insurers exiting the Florida Market in order to reduce their hurricane exposure,
- Continued growth in Florida's population,
- Insurers concern about frequency of mold and sinkhole claims,
- Decrease in investment income, and
- Rate inadequacies

During 2004, Citizens' premium rates increased on average 8% and 11% for residential policies written in the Personnel Line Account and High Risk Account, respectively.

Premiums ceded to the FHCF totaled $177 million and $156 million during 2004 and 2003, respectively, and are included in net earned premiums. The increase in FHCF premium is attributed to an increase in exposure caused by growth in policies in force. The Company did not enter into any excess loss reinsurance agreements in 2004 or 2003, other than its participation in the FHCF. In addition, the FHCF increased capacity and reduced the industry retention which resulted in higher absolute premiums.

During 2004 and 2003, premiums ceded to certain Takeout Companies totaled $136 million and $24 million, respectively.

Losses and LAE incurred increased $2.5 billion, or 1,106%, due mainly to (1) losses incurred related to the four hurricanes and (2) increase in exposure caused by growth in new business.

Financial Analysis (continued)

Non-hurricane combined Loss and LAE Ratio was 29% for 2004 compared to 27% for 2003. The Company experienced a favorable trend in incurred fire losses due to a lower claim frequency in 2004 compared to the prior year. This savings was, however, offset by an increase in sinkhole losses due to increased claim frequency and severity in 2004 compared to the prior year. 802 sinkhole claims were reported in accident year 2004 compared to 354 claims reported in 2003. Management expects both our sinkhole exposure and incurred losses to increase in 2005.

Other underwriting expenses increased $41 million, or 27%, in 2004 primary due to an increase in policies in force. Certain underwriting expenses, such as producer commissions and premium taxes, are determined based on written premiums. As written premiums increase, these expenses will increase proportionately. During 2004, commission and premium tax expenses consisted of 54% and 14% of total underwriting expenses, respectively. During 2003, commission and premium tax expenses consisted of 59% and 11% of total underwriting expenses, respectively.

Non-operating expenses consist mainly of net investment income, and interest expense. During 2004, investment income, net of investment related expenses, decreased $5.6 million, or 29%. Approximately $2.8 million of this variance relates to line of credit fees and note issuance costs. The Line of Credit Agreements were not renewed during 2004.

Interest expense decreased $2 million, or 2%, in 2004. The decrease is a result of debt maturities of $275 million paid during 2004. Debt outstanding as of December 31, 2004 and 2003 was $2.1 billion and $1.7 billion, respectively.

Economic Factors

Management continues to administer programs designed to reduce the number of polices written by Citizens. As a residual market mechanism, the mission of Citizens is to provide property insurance to applicants who are in good faith entitled to obtain insurance through the voluntary market but are unable to do so. Citizens' depopulation program is designed to reduce exposure by providing incentives to private insurers to remove policies from Citizens and to write these policies for their own account. The private market has responded by removing policies from the both the Personal Lines Account and the High-Risk Account. During 2004, 145,959 PLA policies and 12,457 HRA policies have been assumed by private insurers.

Citizens' rate development methodology is based on the highest average premium (calculated for each county in Florida) charged by other residential insurers. This method ensures that Citizens rates are among the highest for each county within Florida. During 2004, Citizens increased homeowner multiperil rates and residential fire/dwelling rates 4.4% and 17.7% respectively, and increased residential wind-only rates for the High-Risk Account 11.6%. Rate increases were implemented to help fund rising losses and claim related expenses.

Citizens enabling legislation and Plan of operations established a process by which Citizens may levy assessments to recover deficits incurred in a given year. Citizens' determination of the amount of assessment is subject to the verification and approval by the Department of Financial Services.

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Report of Independent Certified Public Accountants

The Board of Governors
Citizens Property Insurance Corporation

We have audited the accompanying basic financial statements of Citizens Property Insurance Corporation (the Company), as of and for the years ended December 31, 2004 and 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Citizens Property Insurance Corporation as of December 31, 2004 and 2003, and the changes in its financial position and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 31, 2005 on our consideration of Citizens Property Insurance Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Management's discussion and analysis on pages i through x and the schedule of supplemental revenues, expenses and claim development information on page 29 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The supplemental statement of net assets (deficit) and statement of revenues, expenses and changes in net assets (deficit) are presented for purposes of additional analysis and are not a required part of the basic financial statements. The supplementary information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects in relation to the basic financial statements taken as a whole.

Ernst & Young LLP

March 31, 2005

Citizens Property Insurance Corporation

Statement of Net Assets (Deficit)

	December 31	
	2004	**2003**
	(In Thousands)	
Assets		
Current assets:		
Cash and cash equivalents	**$ 1,422,375**	$ 1,442,890
Short-term investments	**215,635**	435,140
Deferred policy acquisition costs	**63,981**	66,397
Receivable for securities	**–**	45,340
Investment income due and accrued	**23,848**	24,131
Prepaid reinsurance premiums	**36,300**	5,381
Premiums receivable, net	**6,027**	2,703
Total current assets	**1,768,166**	2,021,982
Noncurrent assets:		
Long-term investments	**2,548,479**	2,292,351
Deferred takeout bonus	**36,742**	10,146
Fixed assets, net	**6,797**	5,633
Other assets	**1,143**	218
Total noncurrent assets	**2,593,161**	2,308,348
Total assets	**$ 4,361,327**	$ 4,330,330

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	December 31 2004	2003
	(In Thousands)	
Liabilities and net assets		
Current liabilities:		
Loss reserves	**$ 1,458,495**	$ 112,645
Loss adjustment expense reserves	**148,555**	26,060
Unearned premiums	**667,386**	571,000
Current maturities of long-term debt	**–**	275,000
Payable for securities	**–**	116,840
Advance premiums and suspended cash	**67,653**	63,834
Federal income taxes payable	**54,899**	54,899
Interest payable	**36,550**	44,116
Taxes and fees payable	**30,972**	22,774
Other current liabilities	**32,226**	28,306
Total current liabilities	**2,496,736**	1,315,474
Noncurrent liabilities:		
Long-term debt	**2,115,624**	1,377,163
Total noncurrent liabilities	**2,115,624**	1,377,163
Total liabilities	**4,612,360**	2,692,637
Net assets:		
Invested in capital assets	**6,797**	5,633
Unrestricted	**(257,830)**	1,632,060
Total net assets (deficit)	**(251,033)**	1,637,693
Total liabilities and net assets (deficit)	**$ 4,361,327**	$ 4,330,330

See accompanying notes.

Citizens Property Insurance Corporation

Statement of Revenues, Expenses, and Changes in Net Assets (Deficit)

	Years Ended December 31 2004	2003
	(In Thousands)	
Operating revenue:		
Premiums earned	**$ 1,022,503**	$ 823,902
Operating expenses:		
Losses incurred	**2,493,127**	203,560
Loss adjustment expenses incurred	**212,887**	20,768
Service company fees	**12,562**	11,687
Producer commissions, net	**104,041**	89,158
Taxes and fees	**26,482**	17,113
Processing and other fees	**1,753**	1,636
Other underwriting expenses	**38,458**	28,397
Takeout bonus expense	**8,037**	2,587
Total operating expenses	**2,897,347**	374,906
Operating (loss) income	**(1,874,844)**	448,996
Nonoperating revenues (expenses):		
Net investment income	**106,589**	105,789
Interest expense	**(117,574)**	(119,530)
Income tax benefit	**–**	2
Line of credit fees and note issuance costs	**(2,897)**	(5,751)
Total nonoperating expenses	**(13,882)**	(19,490)
Change in net assets (deficit)	**(1,888,726)**	429,506
Net assets, beginning of year	**1,637,693**	1,208,187
Net assets (deficit), end of year	**$ (251,033)**	$ 1,637,693

See accompanying notes.

Citizens Property Insurance Corporation

Statements of Cash Flows

	Years Ended December 31	
	2004	**2003**
	(In Thousands)	
Operating activities		
Premiums collected, net of reinsurance	**$ 1,088,465**	$ 1,017,916
Losses and loss adjustment expenses paid	**(1,237,669)**	(168,767)
Payments to employees for services	**(13,977)**	(9,883)
Payments for underwriting expenses	**(187,025)**	(145,275)
Net cash (used in) provided by operating activities	**(350,206)**	693,991
Noncapital activities		
Debt issuance	**750,000**	–
Debt repayment	**(275,000)**	(125,000)
Interest expense paid	**(124,588)**	(123,680)
Tax refunds received	**–**	52,552
Financing costs paid	**(14,987)**	(4,093)
Net cash provided by (used in) noncapital activities	**335,425**	(200,221)
Capital activities		
Fixed assets acquired	**(4,483)**	(3,895)
Net cash used in capital activities	**(4,483)**	(3,895)
Investing activities		
Proceeds from investments sold, matured or repaid	**7,683,766**	3,817,074
Investments acquired	**(7,828,794)**	(4,094,280)
Net investment income received	**143,777**	153,630
Net cash used in investing activities	**(1,251)**	(123,576)
Net (decrease) increase in cash and cash equivalents	**(20,515)**	366,299
Cash and cash equivalents:		
Beginning of year	**1,442,890**	1,076,591
End of year	**$ 1,422,375**	$ 1,442,890

Citizens Property Insurance Corporation

Statements of Cash Flows (continued)

	Years Ended December 31	
	2004	**2003**
	(In Thousands)	
Operating activities		
Operating (loss) income	**$ (1,874,844)**	$ 448,996
Depreciation expense	**3,319**	2,488
Loss on disposal of fixed assets	**(1)**	15
Adjustments to reconcile net cash provided by operating activities:		
(Increase) decrease in operating assets:		
Deferred acquisition costs	**2,416**	(16,738)
Prepaid reinsurance premiums	**(30,919)**	(4,692)
Premium receivable, net	**(3,324)**	(1,860)
Deferred takeout bonuses	**(26,596)**	(4,434)
Other assets	**(925)**	1,489
Increase (decrease) in operating liabilities:		
Loss and loss expenses reserve	**1,468,345**	55,561
Unearned premiums	**96,386**	172,760
Advance premium and suspended cash	**3,819**	27,806
Taxes and fees payable	**8,198**	17,213
Other current liabilities	**3,920**	(4,613)
Net cash (used in) provided by operating activities	**$ (350,206)**	$ 693,991
Noncash supplementary information		
Net unrealized loss on investments	$ 36,905	$ 47,542

See accompanying notes.

1. General

Citizens Property Insurance Corporation (Citizens) was established on August 1, 2002, pursuant to Section 627.351(6), Florida Statutes, to provide certain residential property and casualty insurance coverage to qualified risks in the State of Florida under circumstances specified in the Act. The intent of the legislation is that property insurance be provided through Citizens to applicants who are in good faith entitled to procure insurance through the voluntary market but are unable to do so. Citizens is the successor entity resulting from a combination of the Florida Residential Property and Casualty Joint Underwriting Association (the FRPCJUA) and the Florida Windstorm Underwriting Association (the FWUA). The FRPCJUA was renamed Citizens and the FWUA rights, obligations, assets, liabilities and all insurance policies were transferred to Citizens. Citizens is not required to obtain or to hold a certificate of authority issued by the Florida Department of Financial Services (the Department).

Citizens operates pursuant to a Plan of Operation (the Plan) approved by the Department and under the supervision of a seven member Board of Governors appointed by the Chief Financial Officer of the State of Florida (the Chief Financial Officer). The executive director and senior managers of Citizens are engaged by and serve at the pleasure of the Chief Financial Officer. Since the State of Florida exercises significant control over the appointment of the governing board, Citizens is considered a component unit of the State of Florida.

Pursuant to the Act, all revenues, expenses, assets and liabilities of Citizens shall remain divided into three separate accounts: the Personal Lines Account, the Commercial Lines Account and the High-Risk Account. A brief history of each account follows:

> ***Personal Lines Account history*** - The FRPCJUA began operations on January 21, 1993, after Hurricane Andrew, pursuant to Section 627.351(6), Florida Statutes, to provide certain residential property and casualty insurance coverage to qualified risks in the State of Florida (on a statewide basis) to applicants who are in good faith entitled to procure insurance through the private market but are unable to do so. Residential property and casualty coverage consists of the types of coverage provided to homeowners, mobile homeowners, tenants, condominium unit owners, and similar policies. The policies provide coverage for all perils covered under a standard residential policy, subject to certain underwriting requirements. Such policies exclude windstorm coverage on property within eligible areas. This portion of the FRPCJUA's activities became the Personal Lines Account under Citizens.

1. General (continued)

Commercial Lines Account history **–** The Florida Property and Casualty Joint Underwriting Association (FPCJUA) was activated in early 1994 to provide commercial residential coverage, i.e., coverage for condominium associations, apartment buildings and homeowner associations, to organizations unable to obtain such coverage from a private insurer. During 1995, legislation was enacted to transfer all obligations, rights, assets, and liabilities related to commercial residential coverage from the FPCJUA to the FRPCJUA. The legislation required that the premiums, losses, assets and liabilities be accounted for separately from the FRPCJUA's personal residential business. These policies excluded windstorm coverage on properties within eligible areas. This portion of the FRPCJUA's activities became the Commercial Lines Account under Citizens.

High-Risk Account history **–** The FWUA, which was a residual market mechanism for windstorm and hail coverage in selected areas of the State, was created by an act of the Florida Legislature in 1970 that enacted Section 627.351(2), Florida Statutes. FWUA was a Florida unincorporated association, the members of which were all property insurance companies holding a certificate of authority to provide property insurance coverage in the State. FWUA provided policies of windstorm insurance for property owners within the eligible areas who were unable to obtain such coverage from private insurers. Insured properties include personal residential, commercial residential and commercial non-residential properties.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accounting policies and practices of Citizens conform to accounting principles generally accepted in the United States applicable to a proprietary fund of a government unit. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. With respect to proprietary activities, the Board has adopted GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting*. Citizens has elected to apply all applicable GASB pronouncements as well as FASB pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

2. Summary of Significant Accounting Policies (continued)

The financial statements presented herein relate solely to the financial position and results of operations of Citizens and are not intended to present the financial position of the Department or the results of its operations or its cash flows.

Adoption of New Accounting Standards

Prior to January 1, 2003, Citizens prepared its financial statements in accordance with the accounting standards issued by the Financial Accounting Standards Board (FASB). In June 1999, the Governmental Accounting Standards Board ("GASB") issued Statement No. 34, "*Basic Financial Statements — and Management's Discussion and Analysis — for State and Local Governments*." This standard established financial reporting standards for state and local governments and certain funds of those governmental entities. The State of Florida elected to adopt the provisions of GASB Statement No. 34 for its fiscal year beginning July 1, 2001. During the current year, Citizens adopted the provisions of GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, GASB Statement No. 34, GASB Statement No. 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*; and GASB Statement No. 38, *Certain Financial Statement Note Disclosures*. GASB Statement No. 31 establishes accounting and financial reporting for all investments held by governmental entities. GASB Statement Nos. 34 and 37 changed the reporting model for governmental entities and GASB Statement No. 38 modified certain note disclosure requirements for governmental entities.

GASB Statement No. 34 established standards for financial reporting for all state and local governmental entities, which includes a statement of net assets, a statement of revenues, expenses, and changes in net assets, and a statement of cash flows. It requires net assets to be classified and reported in three components: invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

- Invested in capital assets, net of related debt – The component of net assets consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds are not included in the calculation of invested in capital assets, net of related debt. Rather, that portion of the debt is included in the same net assets component as the unspent proceeds.

2. Summary of Significant Accounting Policies (continued)

- Restricted – This component of net assets includes asset subject to external constraints imposed by creditors (such as through debt covenants), grantors, contributors, laws or regulations of other governments, or constraints imposed by law through constitutional provisions or enabling legislation.

- Unrestricted net assets – This component of net assets consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

The primary impact on Citizens of adopting GASB Statement Nos. 31 and 34 was the requirement to report all investments at fair value and to report the change in the fair value of investments as a component of nonoperating income on the statement of revenues, expenses and changes in net assets. The cumulative effect of this requirement was an immaterial increase in net assets at January 1, 2003. The adoption of GASB Statement Nos. 37 and 38 had no material effect on the financial statements.

Measurement Focus

The financial statements of proprietary funds are prepared using the economic resources measurement focus and the accrual basis of accounting. All assets and liabilities associated with the operations of Citizens are included in the statement of net assets. The statement of revenues, expenses and changes in net assets presents increases (revenues) and decreases (expenses) in total net assets. The statement of cash flows provides information about how Citizens finances and meets the cash flow needs of its activities.

Cash, Cash Equivalents, and Investments

Cash consists of demand deposits held with financial institutions, various highly liquid money market funds, and amounts deposited with the State of Florida Chief Financial Officer's Special Purpose Investment Trust Account (the Special Purpose Account). The Special Purpose Account consists of pooled funds invested by the Chief Financial Officer of the State of Florida under the guidelines provided by Section 18.10, Florida Statutes. Deposits whose values exceed the limits of Federal depository insurance are entirely insured or collateralized pursuant to Chapter 280 of the Florida Statutes, "Florida Security for Public Deposits Act." For purposes of the statement of cash flows, highly liquid investments with original maturities of three months or less at the time of acquisition are considered to be cash.

2. Summary of Significant Accounting Policies (continued)

Investments consist of relatively low-risk, highly liquid fixed-maturity securities and are recorded at market value, which is based on independent quoted market prices. Citizens considers all investments with remaining maturities of one year or less to be short-term.

Note Issuance Costs

Note issuance costs incurred in connection with acquiring notes payable (see Note 6) are deferred and amortized over the life of the note agreements.

Deferred Takeout Bonus

Takeout bonuses incurred in connection with the depopulation of Citizens (see Note 12) are deferred and amortized over the term of the related agreement under which the policy is removed from Citizens, which is generally a three-year period.

Deferred Policy Acquisition Costs

Costs which vary directly with acquiring, renewing and servicing the business such as net commissions, servicing company fees and taxes and fees (see Note 7) are deferred and recognized over the term of the related policy. Amortization of deferred policy acquisition costs recognized for the years ended December 31, 2004 and 2003 was $144,838 and $119,594, respectively.

Fixed Assets

Fixed assets are stated at cost less related accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of three to seven years. Depreciation expense for fixed assets was $3,319 and $2,488 for the years ended December 31, 2004 and 2003.

2. Summary of Significant Accounting Policies (continued)

Loss Reserves and Loss Adjustment Expense Reserves

Liabilities for loss reserves and loss adjustment expense reserves are based on claims adjusters' evaluations and on independent outside actuarial evaluations, using Citizens' loss experience and industry statistics. While the ultimate amount of losses incurred and loss adjustment expenses incurred is dependent on future developments, in management's opinion, these reserves are adequate to cover the future payment of losses. However, no assurance can be given that the ultimate settlement of losses may not vary significantly from the reserves provided. Adjustments, if any, to estimates recorded resulting from subsequent actuarial evaluations or ultimate payments will be reflected in operations in the period in which such adjustments are known or estimable. Citizens does not discount liabilities for loss reserves and loss adjustment expense reserves.

Premiums

Premiums are recorded as earned on a daily pro rata basis over the policy period. The portion of premiums not earned at the end of the period is recorded as unearned premiums.

Premiums receivable includes amounts due from policyholders for billed premiums. Billings are calculated using estimated annual premiums for each policy and are paid either through an installment plan offered by Citizens or in their entirety at the inception of the policy.

Assessments

Assessments made pursuant to the Act and the Plan are recognized as revenue in the period approved by the Board of Governors and the Department and levied by Citizens.

2. Summary of Significant Accounting Policies (continued)

Reinsurance

Premiums ceded under reinsurance agreements are recorded as a reduction of earned premiums over the hurricane season covered by the agreement. Reinsurance recoverables on unpaid losses would be recorded as a reduction of losses incurred and loss adjustment expenses incurred. Reinsurance recoverables on paid losses would be recorded as receivables. All catastrophe reinsurance payments are recorded as premiums ceded and are amortized over the life of the hurricane season for which the payments apply.

Use of Estimates

The preparation of the financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Financial Instruments

The carrying value of cash and cash equivalents, premiums receivable, due from affiliates, producer commissions payable, reinsurance premiums payable and accounts payable and accrued expenses approximates fair value given their short-term nature.

Market Risk

Citizens underwrites residential property and casualty insurance policies in the State of Florida. Therefore, adverse economic changes or certain changes in the insurance laws of the State of Florida could have a significant impact on Citizens' future financial position and results of operations. Approximately 27%, 13%, 4% and 13% of Citizens' insurance coverage exposure lies in Miami-Dade, Broward, Monroe and Palm Beach counties, respectively, as of December 31, 2004. Severe storm activity in any of these counties could have a significant impact on Citizens' future financial position and results of operations.

(In Thousands)

2. Summary of Significant Accounting Policies (continued)

Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, premiums receivable, and investments. The Company's cash management and investment policies restrict investments by type, credit and issuer, and the Company performs periodic evaluations of the credit standing of the financial institutions with which it deals. As of December 31, 2004, management believes the Company had no significant concentrations of credit risk.

Operating Revenues and Expenses

Operating revenues are those revenues that are generated directly from premiums charged to policyholders. Operating expenses include incurred losses and necessary costs incurred to provide and administer residential property and casualty insurance coverage and to carryout programs for the reduction of new and renewal writings.

3. Investments

Citizens investments at December 31, 2004 and 2003 are categorized in the following table to give an indication of the level of risk assumed. Category 1 includes investments that are insured or registered or for which the securities are held by Citizens or its agent in Citizens' name. Category 2 includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in Citizens' name. Category 3 includes uninsured and unregistered investments for which the securities are held by the counterparty, or by its trust department or agent, but not in Citizens' name.

2004	Risk Category			Carrying Amount/
Type	**1**	**2**	**3**	**Fair Value**
U.S. Government and Federally guaranteed obligations	$ 542,148	$ -	$ -	$ 542,148
Federal agency obligations	509,370	-	-	509,370
Commercial paper	82,823	-	-	82,823
Bonds and notes	1,629,773	-	-	1,629,773
	$2,764,114	$ -	$ -	$2,764,114

(In Thousands)

3. Investments (continued)

2003 Type	Risk Category 1	2	3	Carrying Amount/ Fair Value
U.S. Government and Federally guaranteed obligations	$ 617,548	$ –	$ –	$ 617,548
Federal agency obligations	567,130	–	–	567,130
Commercial paper	167,005	–	–	167,005
Bonds and notes	1,375,808	–	–	1,375,808
	$ 2,727,491	$ –	$ –	$ 2,727,491

4. Fixed Assets

A summary of changes in fixed assets and depreciation for the year ended December 31, 2004 follows:

	Beginning Balance	Additions	Reductions/ Adjustments	Ending Balance
Leasehold improvements	**$ 505**	**$ 974**	**$ –**	**$ 1,479**
Furniture and equipment	**5,513**	**1,732**	**(111)**	**7,134**
Other capital assets	**7,521**	**1,777**	**5**	**9,303**
Totals at historical cost	**13,539**	**4,483**	**(106)**	**17,916**
Less accumulated depreciation for:				
Leasehold improvements	**(246)**	**(103)**	**–**	**(349)**
Furniture and equipment	**(3,840)**	**(985)**	**106**	**(4,719)**
Other capital assets	**(3,820)**	**(2,231)**	**–**	**(6,051)**
	$ 5,633	**$ 1,164**	**$ –**	**$ 6,797**

(In Thousands)

4. Fixed Assets (continued)

A summary of changes in fixed assets and depreciation for the year ended December 31, 2003 follows:

	Beginning Balance	Additions	Reductions/ Adjustments	Ending Balance
Leasehold improvements	$ 249	$ 237	$ 19	$ 505
Furniture and equipment	6,821	967	(2,275)	5,513
Other capital assets	3,308	2,691	1,522	7,521
Totals at historical cost	10,378	3,895	(734)	13,539
Less accumulated depreciation for:				
Leasehold improvements	(173)	(73)	–	(246)
Furniture and equipment	(4,819)	(837)	1,816	(3,840)
Other capital assets	(1,145)	(1,578)	(1,097)	(3,820)
	$ 4,241	$ 1,407	$ (15)	$ 5,633

5. Liability for Loss Reserves and Loss Adjustment Expense Reserves

Activity in the liability for loss reserves and loss adjustment expense reserves for the year ended December 31, 2004 are as follows:

Loss reserves and loss adjustment expense reserves, beginning of year	$ 138,705
Incurred related to:	
Current year	2,721,512
Prior years	(15,498)
Total incurred	2,706,014
Paid related to:	
Current year	1,145,602
Prior years	92,067
Total paid	1,237,669
Loss reserves and loss adjustment expense reserves, end of year	$ 1,607,050

(In Thousands)

5. Liability for Loss Reserves and Loss Adjustment Expense Reserves (continued)

Activity in the liability for loss reserves and loss adjustment expense reserves for the year ended December 31, 2003 are as follows:

Loss reserves and loss adjustment expense reserves, beginning of year	$ 83,144
Incurred related to:	
Current year	243,767
Prior years	(19,439)
Total incurred	224,328
Paid related to:	
Current year	124,414
Prior years	44,353
Total paid	168,767
Loss reserves and loss adjustment expense reserves, end of year	$ 138,705

As a result in changes in estimates of insured events in prior years, the provision for loss and loss adjustment expenses decreased by $15,498 in 2004 and decreased by $19,439 in 2003.

The increase in loss and loss adjustment expenses incurred and paid is directly related to catastrophic losses sustained from hurricanes Charley, Frances, Ivan and Jeanne during the current year. Total incurred and paid losses and loss adjustment expenses related to the four storms were $2,407,562 and $987,550 for the year ended December 31, 2004.

Citizens entered into agreements with several companies that provide claim adjustment services. These agreements provide for compensation to the companies based on a graduated fee schedule, based on the cost and type of losses handled by the companies. Compensation for claim services performed during a catastrophe are paid based upon a fee schedule plus an additional amount based on a percentage of paid losses. The agreements are effective for one year, with provisions for automatic renewal for successive one-year periods. In the opinion of management, any additional liability that may ultimately result from unusual loss adjustment expenses will not have a material adverse effect on the financial position or results of operations of Citizens.

6. Notes Payable

Series 1997A issued August 25, 1997 and Series 1999A issued March 31, 1999 – In August 1997 and March 1999, the pre-merger FWUA issued $750 million and $1 billion of secured notes, respectively. The bonds were issued for the purpose of funding losses in the event of a future catastrophe. Repayment and annual debt service of the High-Risk Account bonds will be facilitated through premium and surcharge revenues, unused proceeds of the bonds, amounts available under the High-Risk Account line of credit, regular assessments and emergency assessments, as necessary.

The bonds bear interest ranging from 6.70% to 7.125% per annum. The interest on the bonds is payable semi-annually on February 25th and August 25th. Principal payments of $150,000 were made on these notes during the year ended December 31, 2004. Outstanding maturities and unamortized discounts on these notes were $1,300,000 and $1,450,000, respectively at December 31, 2004 and 2003.

Series 1997A, issued May 13, 1997 – In May 1997, the pre-merger FRPCJUA issued $500 million of Series 1997A Notes for the Personal Lines Account and Commercial Lines Account. The bonds were issued for the purpose of funding losses in the event of a future catastrophe. The bonds are secured by a security interest in emergency assessments. Under certain circumstances the bonds will also be secured by and payable by regular assessments or reimbursements received by or on behalf of Citizens from the Florida Hurricane Catastrophe Fund (FHCF - see Note 10). The trust indenture contains covenants that impose restrictions on Citizens' ability to sell, lease, pledge, assign or otherwise encumber or dispose of its security interest. The bonds are a direct and general obligation of Citizens and are secured ratably and without preference with Citizens' Personal Lines Account and Commercial Lines Account line of credit agreement (see Note 9).

The bonds bear interest ranging from 7.45% to 7.625% per annum. The interest on the bonds is payable semi-annually on January 1st and July 1st. The principal reduction on these notes during the years ended December 31, 2004 and 2003 was $125,000 and $125,000. Outstanding maturities and unamortized discounts on these notes were $100,000 and $225,000, respectively at December 31, 2004.

(In Thousands)

6. Notes Payable (continued)

Series 2004A through 2004I Bonds – During May 2004, Citizens issued $750 million of senior secured bonds for the purpose of funding losses in the High-Risk account in the event of a future catastrophe. The bonds were issued in multiple series and bear interest at variable, auctioned rates, based on 30-day LIBOR, for generally successive 28-day auction periods. These bonds are secured by pledged revenues which consist of moneys and investments held in accounts established under the trust indenture, proceeds from any regular assessment and/or reimbursements received from the FHCF.

A schedule of debt service requirements, including principal and interest, is as follows:

Year Ending December 30	Principal	Interest	Total
2005	$ –	$ 125,000	$ 125,000
2006	–	132,500	132,500
2007	400,000	126,263	526,263
2008	–	112,275	112,275
2009	–	114,750	114,750
2010-2014	–	581,250	581,250
2015-2019	1,325,000	519,250	1,844,250
2020-2024	425,000	65,250	490,250
Total	$ 2,150,000	$ 1,776,538	$ 3,926,538

The total interest expense on the notes for the years ended December 31, 2004 and 2003 was $120,372 and $123,857, including discount amortization of $552 and $459 and is included in “Interest expense” in the accompanying statements revenues, expenses and changes in net assets.

Total deferred financing costs related to all notes was $29,129 and $17,039 at December 31, 2004 and 2003 and is included in “Long term debt” in the Statement of Net Assets.

6. Notes Payable (continued)

Interest Rate Swap Agreements – Citizens had no interest rate exchange agreements outstanding at December 31, 2004 and 2003. However, in connection with the issuance of the Series 1997A Notes issued May 13, 1997, Citizens entered into interest rate exchange agreements with various counterparties for notional amounts of $500 million. The interest rate exchange agreements were terminated during 1998, 2001 and 2002, for which Citizens received termination payments of $7,304, $7,632, and $10,250, respectively. The gain on terminated interest rate swap agreements has been deferred and is being amortized over the remaining term of the terminated agreements using the effective interest method. The total amount of deferred gain and accrued interest amortized and recognized as a reduction of interest expense for the year ended December 31, 2004 and 2003 was $2,798 and $4,327.

7. Producer Commissions and Servicing Company Fees

Citizens contracted with various licensed producers in the State of Florida. These agreements provide for commissions paid to the producers at rates established by the Board and calculated as a percentage of direct written premiums, net of certain surcharges.

Additionally, Citizens entered into agreements with servicing companies to provide underwriting and policy management services. These agreements provide for monthly compensation to the companies based on a flat fee per policy based on the number of policies processed during an assigned task. Service carrier fees expensed during 2004 and 2003 were $12,562 and $11,687.

8. Income Taxes

Pursuant to a determination letter received from the Internal Revenue Service, Citizens is exempt from federal income tax under Section 501(a) of the Internal Revenue Code and as such, is liable for income taxes only on business income unrelated to the purpose for which it is exempt.

8. Income Taxes (continued)

During 2002, FWUA transferred its assets and liabilities to Citizens in accordance with Florida Statute 627.351(6)(l)(2). Citizens filed federal income tax refund claims in excess of $182 million related to the transfer. During 2004 and 2003, Citizens received federal and state refunds for approximately $8 million and $69 million, respectively, related to the 2002 taxable year. The amount has been recorded as a liability in the accompanying statement of financial position. Citizens has not recorded any other anticipated refund since it expects that the claim for refund will be contested by the IRS due to the size of the refund and the refund's relationship to Citizens as the former FRPCJUA.

9. Line of Credit Agreements

Line of Credit, High-Risk Account - Effective August 6, 1997 (as amended and restated June 1, 1999 and further amended and restated June 16, 2000 and August 1, 2001 and July 26, 2002), the pre-merger FWUA entered into a Credit Agreement with various lending institutions under which it may currently borrow up to $480 million. The Credit Agreement was secured by and repaid through the collection of High-Risk Account assessments. The expiration date of the amended credit agreement is July 15, 2004. Citizens was required to pay an annual commitment fee of .30% of the daily amount by which the aggregate amount of the commitment exceeds the outstanding principal amount of the loan. The commitment fee percentage was based on Moody's Investors Service, Inc. (Moodys) and Standard & Poor's Ratings Services (S&P) ratings of A- and A3, respectively, on the High-Risk Account Series 1997A Notes. Annual commitment fees associated with this credit agreement were $900 for the year ended December 31, 2003. This agreement was not renewed after July 25, 2003.

Line of Credit, Personal & Commercial Lines Accounts – Effective May 13, 1997, the pre-merger FRPCJUA entered into a $1.5 billion credit agreement (the "Line of Credit") with a syndication of banks. The Line of Credit was secured by a security interest in emergency assessments. Under certain circumstances, the Line of Credit was also be secured by and payable by regular assessments or reimbursements received by or on behalf of Citizens from the FHCF. Pursuant to the amendment dated March 25, 2003, the available borrowing amount was reduced to $675 million. The expiration date of the amended credit agreement was March 24, 2004. Citizens was required to pay an annual commitment fee of .37% of the daily amount by which the aggregate amount of the commitment exceeds the outstanding principal amount of the loan.

(In Thousands)

9. Line of Credit Agreements (continued)

The commitment fee percentage was based on Moody's and S&P ratings of A and A2, respectively; on the Personal & Commercial Lines Accounts' long-term debt. Annual commitment fees associated with this credit agreement were $591 and $2,884 for the years ended December 31, 2004 and 2003. This agreement was not renewed after March 24, 2004.

10. Reinsurance Agreements

Citizens participates in the Florida Hurricane Catastrophe Fund (the FHCF). The FHCF will reimburse Citizens a specified percentage of losses incurred relating to a hurricane in Florida if a prescribed retention is reached. Premiums ceded to the FHCF, net of refunds received, totaled $177,075 and $156,214 during 2004 and 2003 and are included in "Premiums earned" in the accompanying statements of revenues, expenses and changes in net assets. The High-Risk Account is treated for all FHCF purposes as if it were a separate participating insurer with its own exposures, reimbursement premium and loss reimbursement. Likewise, the Personal and Commercial Lines Accounts are viewed together for FHCF purposes, as if the two accounts were one and represent a single, separate participating insurer with its own exposures, reimbursement premium and loss reimbursement. The FHCF coverages and retention amounts by account are as follows:

	2004		**2003**	
	Coverage Amounts	**Retention Amounts**	**Coverage Amounts**	**Retention Amounts**
Personal and Commercial Lines Accounts	**$ 958 million**	**$ 283 million**	$ 967 million	$ 386 million
High-Risk Account	**$3,404 million**	**$1,007 million**	$2,540 million	$1,012 million

The effect of reinsurance on premiums written and earned is as follows:

	2004		**2003**	
	Premiums		**Premiums**	
	Written	**Earned**	**Written**	**Earned**
Direct	**$ 1,401,086**	**$ 1,304,700**	$ 1,171,996	$ 999,235
Ceded	**(313,118)**	**(282,197)**	(180,026)	(175,333)
Net premiums	**$ 1,087,968**	**$ 1,022,503**	$ 991,970	$ 823,902

10. Reinsurance Agreements (continued)

Citizens is not entitled to any reimbursements related to losses incurred and paid as a result of any of the four hurricanes in 2004 as losses incurred per storm did not exceed the FHCF retention.

Reinsurance contracts do not relieve the Company from its obligation to policyholders. The Company remains liable to its policyholders for the portion reinsured to the extent that any reinsurer does not meet the obligations assumed under their reinsurance agreements.

11. Retirement Plan

Deferred Compensation Plan

Citizens sponsors a 457(b)/401(a) deferred employee savings plan for qualified employees (the Savings Plan). The Savings Plan qualifies as a deferred salary arrangement under Section 401(a) of the Internal Revenue Code. Under the Savings Plan, participating eligible employees may defer a portion of their pretax earnings, up to the Internal Revenue Service annual contribution limit. Citizens matches 100% of each employee's contributions, up to a maximum of 8% of the employee's pretax earnings. Citizens' matching contributions to the Savings Plan were $470 and $396 for the years ended December 31, 2004 and 2003, and are included in "Other underwriting expenses" in the accompanying statements of revenues, expenses and changes in net assets.

12. Depopulation

Pursuant to the Act, Citizens is authorized to adopt one or more programs, subject to approval by the Department, for the reduction of both new and renewal writings. Both of the pre-merger entities, the FRPCJUA and the FWUA, were also authorized to adopt and did enact such programs. However, the FRPCJUA was the only entity authorized to pay bonuses related to such programs. Agreements were entered into with various insurance companies (the Takeout Company or Companies) licensed in the State of Florida to remove policies from the FRPCJUA or the FWUA.

Policies may be removed from Citizens at policy renewal or as part of a bulk assumption (Assumption Agreement). If the Takeout Companies are unable to meet their obligations to policyholders, Citizens may be liable for losses incurred prior to the policy expiration date. In the opinion of management, any losses relating to these transactions will not have a material adverse effect on Citizens' financial position and results of operations.

12. Depopulation (continued)

During 2004 and 2003, Citizens ceded $136,042 and $24,265 in premiums to Takeout Companies pursuant to Assumption Agreements, which is included in "Premiums earned" in the accompanying statements of revenues, expenses and changes in net assets.

Citizens provides policy administration services with respect to the assumed policies. All agreements provide for the Takeout Company to adjust losses. The Takeout Company pays a ceding commission to Citizens to compensate Citizens for policy acquisition costs, which includes servicing company fees, producer commissions, and premium taxes. At December 31, 2004 and 2003, assumed premiums in the amount of $3,327 and $709 were due from certain Takeout Companies.

Certain agreements provide for a policy takeout bonus of up to 25% of policy premium to be paid to the Takeout Companies. Such takeout bonuses have been placed into escrow bank accounts pursuant to an escrow agreement. After three years, funds placed in escrow will be released to the Takeout Companies in accordance with the policy takeout agreement. As of December 31, 2004, $50,104 is held in escrow.

At the end of the three-year period, Citizens requires the Takeout Companies to have an independent audit of the policies for which they are claiming a bonus to determine if the policy is properly classified and is eligible for payment. Based upon results of that audit, Citizens evaluates the original amounts placed into escrow to determine if the escrow account is over or underfunded. During 2004, no adjustments were made to escrow accounts because there were no independent audits performed that would determine whether the accounts were underfunded or overfunded.

(In Thousands)

13. Operating Leases

Citizens leases office space and certain office equipment under various operating leases. Rental expense on operating leases amounted to $1,943 and $1,639 for the years ended December 31, 2004 and 2003. At December 31, 2004, future minimum payments under operating leases are as follows:

2005	$ 1,194
2006	1,306
2007	1,309
2008	1,321
2009	1,176
After 2009	4,250
Total	$ 10,556

14. Commitments and Contingencies

Citizens is involved in legal proceedings incidental to the conduct of its business. Management of Citizens does not believe that the outcome of any of these legal proceedings will have a material adverse effect on the financial condition or results of operations of Citizens.

Pending in the Circuit Court of the Seventeenth Judicial Circuit (Broward County, Florida) is Zimmermanm et. al. v Citizens Property Insurance Corporation (Citizens). The plaintiffs seek class certification for certain policyholders in Dade, Broward, Palm Beach and Monroe Counties and refunds of increases in their homeowners insurance premiums for the years 2000 through 2002 as a result of a Florida Windstorm Underwriting Association ("FWUA") 1999 rate filing. Citizens is the defendant as the successor in interest to the FWUA.

The plaintiffs are the same individuals who litigated Zimmerman et al v. FWUA which litigation was reported in Citizens 2003 Annual Statement. The First District Court of Appeals on April 20, 2004 affirmed a decision of the Circuit Court for Leon County refusing "to order refunds or injunctive relief" but reversed the judgment that "the arbitration resulted in Department approval as a matter of law" as to the rate filing at issue.

14. Commitments and Contingencies (continued)

The First District Court stated in its decision that "As for relief, if any, in the form of an order "that premium charged each policyholder constituting the portion of the rate above that which was actuarially justified be returned to such policyholder in the form of a credit or refund," the Department of Insurance, not the cirucit court, has responsibility for reviewing insurance rates and rate increases and determining whether "a rate or rate change is excessive....or unfairly discriminatory."

The plaintiffs in the current litigation have in essence refiled the matter in a different judicial circuit.

Citizens' management does not believe that an unfavorable outcome is likely.

Scylia Properties, LLC and William D. Clark v. Citizens Property Insurance Corporation. Plaintiffs in this certified class action are seeking damages equal to the limits of their Citizens' policies pursuant to Florida's Valued Policy Law, Section 627.702, Florida Statutes, which states that in the event of a total loss of any building insured by an insurer to a covered peril, the insurer's liability, if any, under the policy for such total loss shall be the amount of money for which the property was insured. This action is based on a recent opinion issued by the Fourth District Court of Appeal in the matter styled *Mierzwa v. Florida Windstorm Underwriting Association*, 877 So.2d 774 (Fla. 4th DCA 2004). In *Mierzwa*, the Fourth District held that the Valued Policy Law required an insurer to tender full policy limits in the event of a total loss, even if perils not covered under the insurance policy (i.e., flood) contributed to the total loss.

In this case, plaintiff's properties were damaged by a combination of wind, a peril covered under the policy, and flood, an excluded peril. Citizens believes that the *Mierzwa* ruling is erroneous and impermissibly permits homeowners to obtain a double recovery from both their flood and wind policies well in excess of the value of their homes. It is Citizens' position that it is entitled to a setoff of any amounts paid by the flood carrier for damage to the insured property.

While Citizens intends to vigorously defend Plaintiffs claims in this matter, Citizens has agreed with counsel for Plaintiffs that class certification is appropriate in this case so that the liability of Citizens, if any, under the Valued Policy Law with respect to all affected insureds can be determined in a single forum.

14. Commitments and Contingencies (continued)

This case remains in its infancy and no discovery has taken place. As such, we are unable to determine on the likelihood of a favorable or unfavorable outcome or provide a fair and reasonable estimate of the amount of any loss which Citizens may eventually sustain.

15. Assessments

Citizens' enabling legislation and Citizens' Plan establish a process by which Citizens may levy assessments to recover deficits incurred in a given plan year by account. The Plan provides for deficits to be determined in accordance with accounting principles generally accepted in the United States adjusted for certain items. Deficits are calculated separately and assessments are levied separately for each of Citizens' three accounts.

When a deficit is incurred in any account in a given plan year, regular assessments are levied on assessable insurers, as defined in Section 627.351(6), Florida Statutes, based upon their share of direct written premium for the subject lines of business in the State of Florida for the calendar year preceding the year in which the deficit occurred, as reduced by any credits for voluntary writings for that year. Regular assessments on assessable insureds, collectively, are based on the ratio of the amount being assessed for an account to the aggregate statewide direct written premiums for the subject lines of business for the preceding year.

The adjusted GAAP deficit was $515,490 for the High-Risk Account as of the year ended December 31, 2004 which will be fully funded with a regular assessment. Citizens' determination of the amount of regular assessments to be levied is subject to verification and approval by the Citizens' Board of Governors and the Department of Financial Services, which has not occurred as of the audit report date.

Required Supplemental Information

Citizens Property Insurance Corporation

Supplemental Revenues, Expenses, and Claim Development Information

(In Thousands)

	Policy Year Ended									
	1995	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**
Net earned premiums and investment revenue	444,341	521,530	648,109	680,546	480,933	462,207	575,853	754,581	929,691	1,129,092
Unallocated expenses	138,239	196,603	197,729	229,694	267,415	258,843	254,407	283,265	150,578	191,333
Estimated incurred claims and expense, end of policy year	496,668	240,074	174,388	326,199	112,544	35,855	64,812	97,373	243,767	2,721,512
Paid (cumulative) as of:										
End of policy year	290,553	133,797	102,805	206,255	69,471	19,544	41,602	44,863	123,943	1,145,602
One year later	389,292	208,297	141,554	302,455	104,241	27,795	59,874	77,758	200,635	
Two years later	443,252	217,780	149,491	314,598	111,348	28,941	63,625	82,694		
Three years later	449,595	222,366	151,905	318,920	113,198	29,830	64,809			
Four years later	453,712	224,779	153,608	321,162	112,419	30,089				
Five years later	455,632	226,806	154,427	318,455	112,798					
Six years later	456,458	227,814	155,088	318,921						
Seven years later	456,781	228,874	155,138							
Eight years later	454,985	228,959								
Nine years later	455,305									
Reestimated incurred claims and expense:										
End of policy year	496,668	240,074	174,388	326,199	112,544	35,855	64,812	97,373	243,767	2,721,512
One year later	422,352	238,049	157,638	318,084	116,215	31,832	67,838	87,937	222,519	
Two years later	463,805	230,753	156,317	326,602	118,408	31,698	66,654	87,011		
Three years later	458,786	227,558	159,193	327,268	119,342	30,932	66,564			
Four years later	456,539	230,742	158,343	328,721	117,406	30,652				
Five years later	457,793	229,829	157,470	324,993	114,217					
Six years later	457,871	229,682	155,805	319,452						
Seven years later	457,938	229,527	155,465							
Eight years later	457,490	229,113								
Nine years later	455,565									
Increase (decrease) in estimated incurred claims and expense from end of policy year	(41,103)	(10,961)	(18,923)	(6,747)	1,673	(5,203)	1,752	(10,362)	(21,248)	–

Supplemental Information

Citizens Property Insurance Corporation

Statement of Net Assets (Deficit)

December 31, 2004

	Consolidated	Personal Lines Account	Commercial Lines Account	High Risk Account
	(In Thousands)			
Assets				
Current assets:				
Cash and cash equivalents	$ 1,422,375	$ 752,897	$ 170,921	$ 498,557
Short-term investments	215,635	363	50	215,222
Deferred policy acquisition costs	63,981	20,245	3,105	40,631
Receivable for securities	–	–	–	–
Investment income due & accrued	23,848	3,536	626	19,686
Prepaid reinsurance premiums	36,300	35,849	–	451
Premiums receivable, net	6,027	4,568	(134)	1,593
Total current assets	1,768,166	817,458	174,568	776,140
Noncurrent assets:				
Long-term investments	2,548,479	97,297	13,306	2,437,876
Deferred takeout bonus	36,742	36,742	–	–
Fixed assets, net	6,797	6,797	–	–
Other assets	1,143	837	5	301
Inter-account receivable (payable)	–	32,201	(7,960)	(24,241)
Total noncurrent assets	2,593,161	173,874	5,351	2,413,936
Total assets	4,361,327	991,332	179,919	3,190,076
Liabilities and net assets				
Loss reserves	1,458,495	298,971	106,864	1,052,660
Loss adjustment expense reserves	148,555	40,992	7,669	99,894
Unearned premiums	667,386	292,946	21,834	352,606
Advance premiums and suspended cash	67,653	31,502	2,838	33,313
Federal income taxes payable	54,899	–	–	54,899
Interest payable	36,550	3,354	459	32,737
Taxes and fees payable	30,972	3,440	263	27,269
Other current liabilities	32,226	23,842	950	7,434
Total current liabilities	2,496,736	695,047	140,877	1,660,812
Noncurrent liabilities:				
Long-term debt	2,115,624	87,741	11,999	2,015,884
Total liabilities	4,612,360	782,788	152,876	3,676,696
Net assets:				
Invested in capital assets	6,797	6,797	–	–
Unrestricted	(257,830)	201,747	27,043	(486,620)
Total net assets (deficit)	(251,033)	208,544	27,043	(486,620)
Total liabilities and net assets (deficit)	$ 4,361,327	$ 991,332	$ 179,919	$ 3,190,076

Citizens Property Insurance Corporation

Statement of Revenues, Expenses, and Changes in Net Assets (Deficit)

Year Ended December 31, 2004

	Consolidated	Personal Lines Account	Commercial Lines Account	High Risk Account
	(In Thousands)			
Operating revenue:				
Premiums earned	$ 1,022,503	$ 456,175	$ 54,109	$ 512,219
Operating expenses:				
Losses incurred	2,493,127	698,565	113,271	1,681,291
Loss adjustment expenses incurred	212,887	65,587	6,245	141,055
Service company fees	12,562	12,562	–	–
Producer commissions, net	104,041	31,970	7,175	64,896
Taxes and fees	26,482	11,662	1,095	13,725
Processing and other fees	1,753	1,738	15	–
Other underwriting expenses	38,458	22,232	1,776	14,450
Takeout bonus expense	8,037	8,037	–	–
Total operating expenses	2,897,347	852,353	129,577	1,915,417
Operating loss	(1,874,844)	(396,178)	(75,468)	(1,403,198)
Nonoperating revenues (expenses):				
Net investment income	106,589	35,050	5,548	65,991
Interest expense	(117,574)	(8,366)	(1,144)	(108,064)
Line of credit fees and note issuance costs	(2,897)	(673)	(106)	(2,118)
Total nonoperating expenses	(13,882)	26,011	4,298	(44,191)
Change in net assets (deficit)	(1,888,726)	(370,167)	(71,170)	(1,447,389)
Net assets, beginning of year	1,637,693	578,713	98,212	960,768
Net assets (deficit), end of year	$ (251,033)	$ 208,546	$ 27,042	$ (486,621)

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Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of the Financial Statements in Accordance With *Government Auditing Standards*

The Board of Governors
Citizens Property Insurance Corporation

We have audited the financial statements of Citizens Property Insurance Corporation as of and for the years ended December 31, 2004 and 2003, and have issued our report thereon dated March 31, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Citizens Property Insurance Corporation's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by errors or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance

As part of obtaining reasonable assurance about whether Citizens Property Insurance Corporation's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board of Governors, management and Auditor General of the State of Florida and is not intended to be and should not be used by anyone other than these specified parties.

Ernst & Young LLP

March 31, 2005